

Supreme Court, U. S.

FILED

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APPENDIX

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In The  
**Supreme Court of the United States**  
October Term, 1976

No. **76-1393**  
Civil

JACK D. RINGWALT,  
*Petitioner,*

vs.

UNITED STATES OF AMERICA,  
*Respondent.*

PHILIP L. LIESCHE and URSULA A. LIESCHE,  
*Petitioners,*

vs.

UNITED STATES OF AMERICA,  
*Respondent.*

JACK D. RINGWALT and JEAN W. RINGWALT,  
*Petitioners,*

vs.

UNITED STATES OF AMERICA,  
*Respondent.*

**PETITION FOR WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE EIGHTH CIRCUIT**

HAROLD W. KAUFFMAN  
and WILLIAM A. DAY, JR.,  
of GROSS, WELCH, VINARDI, KAUFFMAN & DAY  
525 Farm Credit Building  
Omaha, Nebraska 68102  
*Attorneys for Petitioners.*

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OPINION  
UNITED STATES COURT OF APPEALS  
FOR THE EIGHTH CIRCUIT

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No. 76-1285

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Jack D. Ringwalt,  
vs.  
United States of America,  
*Appellant,*  
*Appellee.*

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No. 76-1286

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Philip L. Liesche and  
Ursula A. Liesche,  
vs.  
United States of America,  
*Appellants,*  
*Appellee.*

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No. 76-1287

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Jack D. Ringwalt and  
Jean W. Ringwalt,  
vs.  
United States of America,  
*Appellants,*  
*Appellee.*

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Appeals from the United States District Court  
for the District of Nebraska

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Submitted: December 16, 1976  
Filed: February 16, 1977

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Before STEPHENSON and HENLEY, Circuit Judges,  
and MEREDITH,\* District Judge.

STEPHENSON, Circuit Judge.

Jack D. Ringwalt and other taxpayers' appeal from the district court's<sup>2</sup> judgment disallowing their claims for income tax refunds for the year 1967. In this appeal appellants contend the district court erred in concluding that certain corporate transactions constituted a corporate reorganization rather than a liquidation producing more favorable tax treatment. For the reasons stated below, we affirm.

The basic facts are described in a stipulation adopted by the district court. In 1949 Ringwalt organized a general insurance agency entitled Ringwalt & Liesche, Inc. (R & L, Inc.). Ringwalt, owning 84% of the shares in the corporation, served as its president. On April 30, 1959, Ringwalt established a trust for the benefit of his children, and he transferred all of his shares in R & L, Inc. to himself as trustee. The trust, commonly known as a Clifford Trust, was specified to last until May 1, 1969, with the trust income being distributable and taxable to the children during the ten-year period. Ringwalt retained a reversionary interest in the trust corpus and

\* The Honorable James H. Meredith, Chief Judge, United States District Court for the Eastern District of Missouri, sitting by designation.

<sup>1</sup> Reference to taxpayers includes Jack Ringwalt, Jean Ringwalt, Philip Liesche, and Ursula A. Liesche.

<sup>2</sup> The Honorable Robert V. Denney, United States District Judge for the District of Nebraska.

held various administrative powers as trustee, including sole discretion to allocate trust receipts between principal and income.

The critical events for purposes of this appeal consist of the sale by R & L, Inc. of a major asset, the dissolution of R & L, Inc., and the subsequent formation of a new insurance corporation. The record reflects that Ringwalt had formed several insurance companies, including National Fire and Marine Insurance Company. R & L, Inc. owned 51% of the shares in National Fire and Marine, but on March 16, 1967, sold its entire interest to Berkshire-Hathaway, Inc. R & L, Inc. realized a taxable gain on the sale exceeding \$700,000. Shortly afterward, the shareholders of R & L, Inc. adopted a resolution authorizing dissolution of the corporation effective March 31, 1967. Ringwalt & Liesche Co. (R & L Co.) was organized on April 1, 1967, with respective shareholders similar to those of R & L, Inc. but with one exception: Ringwalt, rather than the trust, obtained an 84% interest in the new corporation. R & L Co. purchased the operating assets and corporate name of R & L, Inc. and proceeded to conduct the business formerly conducted by R & L, Inc. in substantially the same manner and at the same location.

On April 1, 1967, R & L, Inc.'s assets were distributed to its shareholders in connection with its dissolution. In particular, \$932,754.06 was distributed to Ringwalt as trustee of the short-term trust. These funds were subsequently reinvested in publicly-held securities because, in Ringwalt's view, investment in R & L Co. would have been unduly speculative.

In their individual federal income tax returns for the year 1967, Ringwalt and the other taxpayers treated the distribution received from R & L, Inc. as a corporate liquidation<sup>3</sup> and reported long-term capital gain. R & L, Inc., similarly treating the distribution as a liquidation,<sup>4</sup> reported no gain with respect to the sale of the National Fire and Marine stock or the transfer of the operating assets to R & L Co. In contrast, the Internal Revenue Service determined that the series of transactions through which R & L, Inc. transferred its assets to R & L Co. and then dissolved constituted a corporate reorganization<sup>5</sup> rather than a liquidation. Accordingly, the Internal Revenue Service treated the liquidating distribution as essentially equivalent to a dividend, which is ordinary income,<sup>6</sup> as opposed to capital gain, which would have been appropriate if the transactions were treated as a corporate liquidation. Income tax deficiencies were assessed against Ringwalt and the other taxpayers; Ringwalt's deficiency was approximately \$150,000.

After payment of the tax, the taxpayers initiated refund actions in the district court. The district court, holding in favor of the United States, concluded that the dissolution of R & L, Inc. and subsequent creation of R & L Co. was correctly treated as a corporate reorganization, and the court dismissed the taxpayers' claims for refunds.

<sup>3</sup> See I. R. C. § 331 (a) (1).

<sup>4</sup> See I. R. C. § 337 (a).

<sup>5</sup> See I. R. C. § 368 (a) (1) (D).

<sup>6</sup> See I. R. C. § 356.

The central issue in this appeal obviously is whether the series of corporate transactions described above should be treated as a corporate reorganization or a liquidation. A corporate liquidation consists of the cessation of business by the corporation and the distribution of its assets to its shareholders. See, e.g., I. R. C. § 332. A corporate reorganization constitutes a continuation of business activity by the same shareholders in modified corporate form. See I. R. C. § 368. See generally B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 14.54 (3rd ed. 1971).

In a liquidation, favorable tax treatment may be appropriate in that the distribution can be reported as a capital gain by a shareholder, and no gain need be recognized by the corporation. See I. R. C. §§ 331 and 337. Nevertheless, such advantageous tax treatment is denied when an ostensible liquidation is tainted by reincorporation of the original corporation's operating assets in a "new" corporation controlled by the same shareholders. See I. R. C. § 368. In that situation, the series of corporate transactions constituting a liquidation-reorganization is collapsed, and the tax treatment accorded to reorganizations preempts that accorded to complete liquidations.<sup>7</sup> See *Babcock v. Phillips*, 372 F.2d 240, 242-44 (10th Cir.), cert. denied, 387 U.S. 918 (1967); *Davant v. Commissioner*, 366 F.2d 874, 879-83 (5th Cir. 1966), cert. denied, 386 U.S. 1022 (1967); *Commissioner v. Morgan*, 288 F.2d 676, 679-80 (3d Cir.), cert. denied, 368 U.S. 836 (1961); *Liddon v. Commissioner*, 230 F.2d 304, 307-09 (6th Cir.),

<sup>7</sup> Distributions of money or property by the corporation to its shareholders incident to the reorganization generally will constitute ordinary dividend income. I. R. C. § 356.



*cert. denied*, 352 U. S. 824 (1956); *Bard-Parker Co. v. Commissioner*, 218 F. 2d 52, 56-57 (2d Cir. 1954), *cert. denied*, 349 U. S. 906 (1955); *Lewis v. Commissioner*, 176 F. 2d 646, 648-49 (1st Cir. 1949); *Survaunt v. Commissioner*, 162 F. 2d 753, 756-59 (8th Cir. 1947).

We conclude that the dissolution of R & L, Inc. and concomitant incorporation of R & L Co. should be construed as a reorganization rather than a liquidation. The series of transactions that took place in the instant case appears governed by I. R. C. § 368 (a) (1) (D), which defines a reorganization as:

a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under Sections 354, 355, or 356.

To hold otherwise would be to recognize form over substance under circumstances in which there was a continuation of an existing business enterprise as opposed to the termination of a going concern. *See Davant v. Commissioner*, *supra*, 366 F. 2d at 879-87; *Commissioner v. National Bellas Hess, Inc.*, 220 F. 2d 415, 418-21, *rehearing denied*, 225 F. 2d 340 (8th Cir. 1955).

Taxpayers' most critical contention, in claiming that the series of corporate transactions described above should not have been treated as a reorganization, is that a reorganization requires a consistency of ownership between

the original corporation and the surviving corporation, allegedly absent in this case. *See, e.g., Halvering v. South-west Corp.*, 315 U. S. 194, 201-02 (1942). Taxpayers emphasize, in this regard, that Ringwalt held an 84% interest in R & L, Inc. only as trustee under a short-term trust and owned in his individual capacity an 84% interest in R & L Co. Accordingly, they assert that the common control requirement for a reorganization under Section 368 (a) (1) (D) has not been met.<sup>8</sup> The government contends, however, that Ringwalt did have sufficient control as trustee for the Clifford Trust in order to satisfy the common control element of a reorganization.

In determining that the continuity of interest requirement had been established in the instant case, the district court specifically found that Ringwalt was treated appropriately as the owner of 84% of the R & L, Inc. stock because of the significant incidence of his ownership over the trust property. We agree. The district court's finding is adequately supported by the record.

Assessing continuity of interest ultimately depends upon proof of beneficial ownership without regard to the existence or absence of legal title. *See Bondy v. Commissioner*, 269 F. 2d 463, 466-67 (4th Cir. 1959); *Commissioner v. National Bellas Hess, Inc.*, *supra*, 220 F. 2d at 421. *Cf. Kamborian v. Commissioner*, 469 F. 2d 219, 221-

<sup>8</sup> In a reorganization, one or more of the shareholders of the transferor corporation must own at least 80% of the stock of the transferee corporation. *See* I. R. C. § 368 (a) (1) (D). The key question in this case is whether Ringwalt was a "shareholder" of the transferor corporation in view of his powers as trustee of the Clifford Trust.

22 (1st Cir. 1972). The only beneficial right that Ringwalt relinquished under the trust agreement was the right to receive trust receipts allocable to income. However, Ringwalt had numerous powers of administration over the trust. The trust assets were subject to execution by Ringwalt's creditors. Ringwalt also retained a reversionary interest in the corpus of the trust to insure that he would be entitled to total control after ten years.

Most significantly, examination of the declaration of trust reveals that Ringwalt as trustee possessed extensive power to allocate trust receipts between principal and income. I. R. C. § 677 (a) (2) provides that the grantor of a trust shall be treated as the owner when the trust income may be held or accumulated, in the grantor's uncontrolled discretion, for future distribution to himself.<sup>9</sup> See *Helvering v. Clifford*, 309 U.S. 331, 334-38 (1940). Cf. *Swanson v. Commissioner*, 518 F.2d 59, 63 (8th Cir. 1956). In accordance with Ringwalt's powers as trustee, the 1967 liquidating distribution received from dissolution of R & L, Inc. was allocated to principal, held by the trust for future distribution and actually distributed to Ringwalt upon termination of the trust in 1969.

Under these circumstances, it appears that Ringwalt should be treated as the owner of the Clifford Trust, pur-

<sup>9</sup> Section 677 infers that the grantor will not be treated as the owner of a trust if his power to pay or accumulate income for his own benefit can only affect the beneficial enjoyment of the income after ten years. Nonetheless, we reject appellants' suggestion that a grantor cannot be treated as the owner of a trust if distribution of accumulated income takes place after the ten-year period. Section 677 attributes ownership to a grantor whenever the power to pay or accumulate income is exercisable during the ten-year period, without regard to the timing of actual distribution.

suant to section 677 (a) (2),<sup>10</sup> and correspondingly we hold that the common control requirement for a reorganization, defined by section 368, was satisfied.<sup>11</sup> See *United States v. Adkins-Phelps, Inc.*, 400 F.2d 737, 740-43 (8th Cir. 1968). The transactions that occurred in the instant case, which in substance were really a continuation of the insurance business rather than its cessation were properly characterized as a reorganization.

Affirmed.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS,  
EIGHTH CIRCUIT.

<sup>10</sup> Interestingly, Ringwalt did report the gain from the R & L, Inc. liquidation distribution on his individual income tax return for the year 1967.

<sup>11</sup> Ringwalt alternatively contends that the R & L, Inc. liquidation distribution was taxable in 1969 upon termination of the trust rather than in 1967, the year of dissolution. This assertion was not raised at trial and, in any event, is contradicted by our conclusion that Ringwalt should be characterized as the owner of the short-term trust.

## JUDGMENT

## UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

September Term, 1976

Feb. 16, 1977

Robert C. Tucker, Clerk

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No. 76-1285

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Jack D. Ringwalt,

*Appellant,*

vs.

United States of America,

*Appellee.*

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No. 76-1286

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Philip L. Liesche and  
Ursula A. Liesche,*Appellants,*

vs.

United States of America,

*Appellee.*

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No. 76-1287

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Jack D. Ringwalt and  
Jean W. Ringwalt,*Appellants,*

vs.

United States of America,

*Appellee.*

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Appeals from the United States District Court  
for the District of Nebraska

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These causes came on to be heard on the original designated record of the United States District Court for the District of Nebraska and briefs of the respective parties and were argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in these causes be and the same are hereby affirmed.

February 16, 1977

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OPINION OF THE DISTRICT COURT

(Filed November 12, 1975)

DENNEY, District Judge

These consolidated cases come before the Court for decision following trial to the Court on July 23, 1975. The parties have stipulated to virtually all of the pertinent facts, and that stipulation (Filing #16) is adopted herein as part of the Court's findings of fact, pursuant to F. R. Civ. P. 52 (a).

The actions arise under 28 U. S. C. § 1340 for refund of approximately \$420,000 based on claims timely filed pursuant to 26 U. S. C. §§ 6511 and 6532.

In 1967, the plaintiff's were stockholders of Ringwalt & Liesche, Inc. (hereinafter R & L Inc.), a Nebraska corporation, engaged in the insurance business as a general agent. Jack Ringwalt had been the majority shareholder (84%) for several years; however, during the time in question his stock was held by himself as trustee under a



"Clifford" trust for the benefit of his children. A very substantial proportion of the policies written by R & L Inc. were placed with National Indemnity (hereinafter NI) or National Fire and Marine (hereinafter NF & M) insurance companies. R & L Inc. owned a majority of the stock of NF & M and plaintiff Ringwalt was the president of all three companies.

All the stock of NI and NF & M was purchased in 1967 by Berkshire-Hathaway Inc. R & L Inc. then adopted a resolution directing the dissolution and liquidation of the corporation, while the assets of R & L Inc. were to be transferred to a new corporation.

From the sale of NI, R & L Inc. received \$839,100 for the stock it held (cost basis of \$132,799) and distributed the proceeds to its stockholders.

Ringwalt & Liesche Co. (hereinafter R & L Co.) was then formed with the stockholders holding the same percentage of shares as they held in R & L Inc., except that Jack Ringwalt held his percentage (84%) in his own right—not as trustee. When the R & L Inc. stock held by Jack Ringwalt as trustee was redeemed the proceeds were reinvested into publicly held securities and the trust continued without any involvement with the new corporation, R & L Co. Mr. Ringwalt testified that he did not reinvest the proceeds in R & L Co. because he thought such an investment was too speculative due to the fact that the new company, R & L Co. had no control over its largest customers, NI and NF & M. In addition, he stated that the new corporation might seek "Subchapter S" treatment, which would be impossible if a trust was a large shareholder.

The new corporation carried on the business of the old corporation, without substantial change. Ringwalt, Liesche and Wortz continued as Directors and President, Vice-President and Treasurer, respectively. In addition, the new corporation was officed at the same location and retained substantially the same employees. Mr. Ringwalt continued as president of NI and NF & M for six years, when Mr. Liesche became president.

On its Federal Tax Return for 1967, R & L Inc. did not treat the \$706,301 (equal to \$839,100 minus \$132,799) as a gain subject to taxation. On the stockholders' individual tax returns for that year, they treated their share of the distribution as long term capital gain. The District Director then commenced an audit of the 1967 tax returns of both Mr. Ringwalt and Mr. Liesche. Both men filed claims which were allowed and checks were sent in the spring of 1971 to Mr. Ringwalt and Mr. Liesche; however, both men offered to return the checks and informed the District Director of their concern over the holding in *Lewis v. Reynolds*, 248 U.S. 281 (1932). See Stipulation Exhibit No. 12. Shortly thereafter, the District Director determined that R & L Inc. had underpaid its federal income tax for 1967 in the amount of \$176,575.76. While Ringwalt was assessed \$150,347.97, Liesche was assessed \$11,401.18 and Wortz was assessed \$2,467.17. Mr. Ringwalt paid both the deficiency of R & L Inc. and of the trust.

Plaintiffs Ringwalt and Liesche contend that the Government is estopped from seeking a deficiency by reason of the relatively minor (\$2,560.61) refunds they received for that year. In *Lewis v. Reynolds*, 284 U.S. 281 (1932),

the taxpayer sued for a refund of tax for a year for which, due to the passage of time, the Commissioner could not seek a deficiency. The Court held that even though the Commissioner could not seek a deficiency, he was permitted to reaudit the return to determine if the amount claimed as a refund was offset by an improper deduction. Plaintiffs' reliance on *Lewis v. Reynolds* is misplaced as the case of *Burnet v. Porter*, 283 U.S. 230 (1931) is controlling, wherein the Court held that the Commissioner may allow a claim for refund, and then at some time later reopen the case and redetermine the tax.

Turning to the merits of the case, the Government contends that the sums received by plaintiffs were ordinary income as the provisions of 26 U.S.C. § 368 (a) (1) (D) apply. Plaintiffs, however, allege that the "control" provision of § 368 (a) (1) (D) is not satisfied, since R & L Inc. was controlled by a trust, while R & L Co. is controlled by an individual. *Ralph C. Wilson*, 46 T.C. 334 (1966); *David T. Grubbs*, 39 T.C. 42 (1962); and Tres. Reg. § 1.368-1 (b), illustrate the tax consequences of a typical § 368 (a) (1) (D) reorganization. This Court concludes that the issue of "control" is of paramount importance to this case.

The statutory language is as follows:

(The term Reorganization means) . . . A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred . . . The term "control" means the ownership of stock possessing at least 80 percent of the

total combined power of all classes of stock . . . 26 U.S.C. § 368.

The facts of the present case, when applied to the statutory language, indicate that Mr. Ringwalt, as self-appointed trustee, had legal ownership of 84% of the stock of the transferor corporation. He also retained a reversionary interest in the res which was to revert in approximately two years after the transfer of corporate assets. The equitable interest of the trust was never distributed to the beneficiaries, but was kept in the trust. After much research, the Court has found few cases of assistance in resolving the issue before the Court. *Commissioner v. National Bellas Hess*, 220 F.2d 415 (1955), Reh. Den. 225 F.2d 340 (8 Cir. 1955); *Kamborian v. Commissioner*, 469 F.2d 219 (1 Cir. 1972); *West Side Savings & Loan Assn. v. United States*, 494 F.2d 404 (6 Cir. 1974); see also, Rev. Rul. 75-95 (1975).

The present case evidences little business purpose, aside from avoidance of taxes, to a reorganization. When R & L Inc. sold its interest in NI and NF & M, that asset was not necessary to the continuation of the business, when R & L Co. was formed there was virtually no change in the business.

It should be noted that in this case the Clifford trust was formed well before the reorganization; however, the Court is aware of the likelihood that trusts of short duration could be easily employed to defeat the clear purpose of section 368, should the Court deny reorganization status in this case.

For these reasons, the Court must find in favor of the United States. An order in accordance with the find-

ings of fact and conclusions of law is filed contemporaneously herewith.

Dated this 12th day of November, 1975.

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## JUDGMENT OF THE DISTRICT COURT

### O R D E R

(Filed November 12, 1975)

In accordance with the Court's memorandum filed contemporaneously herewith:

IT IS THEREFORE ORDERED that judgment be entered in favor of the defendant in each of the four above captioned cases.

Dated this 12th day of November, 1975.

BY THE COURT

Robert V. Denney

United States District Judge

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## PERTINENT STATUTES

Internal Revenue Code of 1954 (26 U. S. C.):

• • • • •

### [Corporations—Liquidations and Reorganizations]

§ 318. *Constructive ownership of stock.*

(a) *General rule.*—For purposes of those provisions of this sub-chapter to which the rules contained in this section are expressly made applicable—

• • • • •

(2) *Attribution from partnerships, estates, trusts, and corporations.*—

• • • • •

(B) *From trusts.*—

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501 (a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

• • • • •

(b) *Cross references.*—

For provisions to which the rules contained in subsection (a) apply, see—

- (1) section 302 (relating to redemption of stock);
- (2) section 304 (relating to redemption by related corporations);
- (3) section 306 (b) (1) (A) (relating to disposition of section 306);
- (4) section 334 (b) (3) (C) (relating to basis of property received in certain liquidations of subsidiaries);
- (5) section 382 (a) (3) (relating to special limitations on net operating loss carryovers);
- (6) section 856 (d) (relating to definition of rents from real property in the case of real estate investment trusts);
- (7) section 958 (b) (relating to constructive ownership rules with respect to controlled foreign corporations); and



(8) section 6038 (d) (1) (relating to information with respect to certain foreign corporations).

§ 331. *Gain or loss to shareholders in corporate liquidations.*

(a) *General Rule.*—

(1) *Complete liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

. . . . .

§ 337. *Gain or loss on sales or exchanges in connection with certain liquidations.*

(a) *General Rule.*—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

. . . . .

§ 356. *Receipt of additional consideration.*

(a) *Gain or Exchanges.*—

(1) *Recognition of gain.*—if—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) *Treatment as dividend.*—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

. . . . .

§ 368. *Definitions relating to corporate reorganizations.*

(a) *Reorganization.*—

(1) *In general.*—For purposes of parts I and II and this part, the term “reorganization” means—

. . . . .

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(c) *Control.*—For purposes of part I (other than section 304), part II, and this part, the term



"control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

[Trusts]

§ 643. *Definitions applicable to subparts A, B, C, and D*

(a) *Distributable net income.*—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

. . . . .

(3) *Capital gains and losses.* — Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year,

. . . . .

(b) *Income.*—For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

§ 661. *Deduction for estates and trusts accumulating income or distributing corpus*

(a) *Deduction.*—In any taxable year there shall be allowed as a deduction in computing the taxable income

of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

§ 662. *Inclusion of amounts in gross income of beneficiaries of estate and trusts accumulating income or distributing corpus*

(a) *Inclusion.*—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) *Amounts required to be distributed currently.*—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not.

. . . . .

(2) *Other amounts distributed.* — All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.

. . . . .

§ 671. *Trust income, deductions, and credits attributable to grantors and others as substantial owners*

Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. *No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.* [Emphasis added.]

#### § 673. *Reversionary interests*

(a) *General rule.*—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment *within 10 years* commencing with the date of the transfer of that portion of the trust. [Emphasis added.]

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#### § 674. *Power to control beneficial enjoyment*

(a) *General rule.*—The grantor shall be treated as the owner of any portion of a trust in respect of which the

beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(b) *Exceptions for certain powers.*—Subsection (a) shall not apply to the following powers regardless of by whom held:

• • • • •

(2) *Power affecting beneficial enjoyment only after expiration of 10-year period.*—A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

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(8) *Power to allocate between corpus and income.*—A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.

• • • • •

#### § 676. *Power to revoke*

(a) *General rule.*—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.

(b) *Power affecting beneficial enjoyment only after expiration of 10-year period.*—Subsection (a) shall not ap-

*ply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the expiration of such period unless the power is relinquished. [Emphasis added.]*

§ 677. *Income for benefit of grantor*

(a) *General rule.*—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a non-adverse party, or both, may be—

• • • • •

(2) held or accumulated for future distribution to the grantor;

• • • • •

*This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished. [Emphasis added.]*

### LEGISLATIVE HISTORY

The applicable provisions of the Internal Revenue Code of 1954 relating to trusts are analyzed in House Re-

port No. 1337, Senate Report No. 1622, and Conference Report No. 2543 accompanying the 1954 Code. These reports indicate legislative intent in regard to a Clifford trust such as that involved herein. We quote some of the more pertinent comments found in the House Report.

26 U. S. C. § 671.

The above section was new in the 1954 Internal Revenue Code and no similar section was contained in the 1939 Code or those preceding it. The House Report includes these comments:

§ 671. *Trust income, deductions, and credits attributable to grantors and others as substantial owners.*

This section states the general rule that in cases where the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust (to the extent that such items would be taken into account in computing the taxable income and credits of an individual).

• • • • •

*It is also provided in this section that no items of a trust shall be included in computing the income or credits of the grantor (or another person) solely on the grounds of his dominion and control over the trust under the provisions of section 61 (corresponding to sec. 22(a) of existing law). The effect of this provision is to insure that taxability of Clifford type trusts shall be governed solely by this subpart. \* \* \* [Emphasis added.]*

See 1954 U. S. Code Cong. and Adm. News pp. 4351, 4352. Similar language appears in the Senate Report found at pages 5005 and 5006.



26 U. S. Code § 673 (a).

Section 673 was also new in the 1954 Code. Included in the House report are these comments regarding section 673 (a):

§ 673. *Reversionary interests*

This section contains the rules applicable to the short-term trust containing the provision for a reversion to the grantor. The section enacts in statutory form provisions in lieu of those now contained in section 39.22(a)-21(c) of Regulations 118.

Subsection (a) of this section contains the general rule that a grantor shall be considered to be the owner of any portion of a trust (and taxable on the income therefrom) in which he has a reversionary interest in either the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment within a period of 10 years.

See 1954 U. S. Code Cong. and Adm. News, page 4353.

26 U. S. Code § 674

Section 674 likewise was first enacted in the 1954 Code.

The House Report includes these observations:

§ 674. *Power to control beneficial enjoyment*

This section contains provisions similar to those contained in subsection (d) of section 39.22(a)-21 of the regulations, providing for taxability to the grantor of income of a trust where the beneficial enjoyment of the corpus or income is subject to a power of disposition, exercisable by the grantor or by a nonadverse party or both. The general rule is contained in subsection (a) of this section while certain excepted powers are described in subsections (b) and (c).

Paragraph (1) of subsection (b) contains the exception, equivalent to that provided in section 167 (c) of the

1939 Code, under which a grantor is not taxable on income of a trust by reason of a power merely to apply income to the support or maintenance of his dependents. Inasmuch as such a power might subject the grantor to tax under the general rule of this section as well as under the general rule of section 677 (corresponding to sec. 167 of existing law) the exception is provided for in both sections.

Paragraph (2) contains an exception, also provided in the regulations, to the rules set forth in section 672 (d), under which powers exercisable only on giving of notice or at a future date are treated as present powers. Thus under the exception, a power which may only affect the income for a period commencing after 10 years will not subject the grantor to tax during the prior period. This exception correlates with the short-term trust rule in order that more severe tax consequences may not result from a power exercisable after a term of 10 years than from a reversionary interest to take effect after the same period. If the power is still in existence in the eleventh and succeeding years, however, the grantor will be taxable on the income of those years under the general rule since the power will be currently exercisable.

See 1954 U. S. Code Cong. and Adm. News, pp. 4353 and 4354.

26 U. S. Code § 676.

The House Report regarding this section indicates the legislative intent of subsection (b) thereof. It is stated therein:

§ 676. *Power to revoke*

Section 676 is the provision corresponding to section 166 of existing law providing that the grantor is taxable on the income of a trust where either he or any person without adverse interest has the power to revest title to the trust property in the grantor. *This provision is slight-*



*ly modified so as to limit its application in the case of powers exercisable only after the expiration of a period of time. Under existing law the grantor is taxable if the power to revoke is exercisable "at any time". As in the case of a power under section 674, it seems appropriate to correlate the section with the short-term trust provisions of section 673. [Emphasis added.]*

See 1954 U. S. Code Cong. and Adm. News, page 4356.

26 U. S. Code § 677.

The intent of Congress regarding the rule applicable to trusts extending for a ten-year period is again disclosed by the House Report regarding this section:

§ 677. *Income for benefit of grantor*

Section 677 corresponds to section 167 of existing law under which income is taxed to the grantor by reason of a power to vest the income in him or to apply it to his benefit. *A limitation with respect to powers affecting income arising only after the expiration of the period of time specified in section 673 is provided consistent with the treatment in sections 674 and 676. [Emphasis added.]*

See 1954 U. S. Code Cong. and Adm. News, pages 4356, 4357.